

Real Estate Valuation Advocacy Association
(REVAA) and Coalition to Facilitate Appraisal
Integrity Reform (FAIR) Joint Testimony

Presented by
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Before the House Financial Services Committee,
Subcommittee on Insurance, Housing, and
Community Opportunity hearing on
Mortgage Origination: The Impact of Recent
Changes on Homeowners and Businesses

July 13, 2011

**STATEMENT OF DON KELLY BEFORE THE SUBCOMMITTEE ON INSURANCE,
HOUSING, AND COMMUNITY OPPORTUNITY OF THE HOUSE COMMITTEE ON
FINANCIAL SERVICES**

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Introduction and Summary

I am Donald E. Kelly, Executive Director of the Real Estate Valuation Advocacy Association ("REVAA"). I appreciate the opportunity to provide testimony on behalf of REVAA and the Coalition to Facilitate Appraisal Integrity Reform ("FAIR") for the Insurance, Housing, and Community Opportunity Subcommittee's hearing on "Mortgage Origination: The Impact of Recent Changes on Homeowners and Businesses."

With this testimony, I aim to:

- 1) provide the Subcommittee with information about the important role that REVAA and FAIR members play in the valuation industry and the valuable services they provide in the course of a residential real estate appraisal;
- 2) discuss REVAA's and FAIR's proactive efforts to work collaboratively with states to implement registration and regulatory requirements for appraisal management companies ("AMCs");
- 3) provide insight from our industry regarding the regulatory implementation of the "customary and reasonable" compensation requirement contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"); and
- 4) offer our industry experience and expertise as a resource to the Subcommittee as you continue your efforts to reform the mortgage origination process.

Background/Benefits of Working With an AMC

REVAA is a real estate valuation industry trade association that promotes education, high ethical standards, political awareness, and the professional development of the real estate valuation industry.

REVAA believes that homeowners, the mortgage lending industry, and the economy as a whole are best served by a diversified array of real estate valuation products. With growing complexity regarding real estate valuation in today's challenging market, it is vital that end-users have the ability to select the most appropriate valuation service to meet their specific needs.

REVAA members have committed to being proactive in efforts to promote and expand the industry. Our members produce and deliver real estate valuation products including Appraisals, Broker Price Opinions (BPOs), Automated Valuation Models (AVMs), and other innovative valuation methods that benefit mortgage investors, servicers, originators, and borrowers.

FAIR is a coalition of five of the nation's largest AMCs,¹ which operate networks of individual appraisers and appraisal firms for the completion of appraisal reports.

AMCs operate regional and national networks of employee appraisers, independent contractor appraisers, and appraisal companies/firms for the completion of appraisal reports. They act as a centralized appraisal source for mortgage lenders that operate on a wide geographic basis. Rather than contacting hundreds of individual appraisers in each state or jurisdiction, a lender may obtain appraisals through a centralized AMC model. The AMC then works to match the assignment with a qualified, local market appraiser based on numerous factors. The selected appraiser then performs the physical inspection of the property and issues an appraisal report containing the appraiser's opinion of property value. The AMC performs extensive quality control functions on behalf of both the appraiser and the lender to ensure a high quality appraisal report is delivered to the client. Prior to the use of AMCs, there was typically little/no quality control performed prior to the delivery of the appraisal report.

There are significant benefits for both an appraiser and a lender when they work with an AMC. The lender hires an AMC to act on its behalf to maintain an appraiser panel, engage a real estate appraiser, perform the administrative functions involved in the appraisal ordering, tracking, and delivery process, perform quality control functions on behalf of both parties, and handle the invoicing and payment of the appraiser. AMCs are able to provide the highest level of appraiser independence by acting as a firewall between a lender and an appraiser as a neutral third party. In addition to these services, AMCs also have created and/or provided technological innovations in the appraisal industry, including the development of electronic appraisal delivery and the development of supplemental addendums and products to complement the current standardized appraisal forms. AMCs have also provided expertise in the development of the MISMO XML standards and other "landmark" technological developments in the appraisal industry over the past 15 years.

An appraiser benefits from working with an AMC by having an advocate to ensure that no inappropriate or improper attempt is made to influence the appraiser process. Appraisers rely on AMCs to handle marketing, perform panel management, and provide for the efficient payment of appraisal fees. This allows appraisers the opportunity to spend more time actually appraising as opposed to performing the back-office work that is associated with the appraisal profession. In addition to these services, AMCs provide extensive quality control support, which reduces the time that appraisers spend fixing errors and resolving underwriting suspensions and helps to limit appraisers' buyback exposure. The majority of appraisers are individual

¹ These five AMCs include: (1) LSI, a division of Lender Processing Services, Inc.; (2) ServiceLink Valuation Solutions, LLC, a Fidelity National Financial, Inc. company; (3) Valuation Information Technology, LLC d/b/a Rels Valuation; (4) CoreLogic, Inc.; and (5) PCV/Murcor. Rels Valuation is an affiliate of CoreLogic, Inc. and Wells Fargo Bank.

proprietors who have no realistic ability – other than through AMCs – to benefit from having third-party quality control processes performed on their appraisal reports.

In addition to the benefits provided by AMCs to appraisers and lenders, it is important to also note the benefits enjoyed by consumers when an appraisal is procured by a lender through an AMC. The AMC model, which has been utilized by many large lenders for over twenty years, provides efficiencies to the appraisal process that allow mortgage transactions to close in less time and help ensure that services are performed at competitive, market-based prices. The success of the AMC business model has been seen throughout the industry with the result being that nearly 70% of all residential appraisals ordered and produced nationwide are provided through an AMC. Government entities (e.g., the Federal Housing Administration or “FHA”) have also recognized the presence and importance of AMCs in the appraisal industry and have provided specific guidance to lenders that utilize AMCs (e.g., Mortgage Letter 2009-28).

Overview of AMC Functions

AMCs not only manage networks of independent, third-party service providers, but they manage all of the ordering, tracking, quality control and delivery tasks associated with the appraisal process. Below are some of the specific functions that an AMC provides:

- Recruit and qualify vendors for their networks, by verifying appraisal licensure and/or certification, checking references, performing background checks, performing examinations, and auditing work samples;
- Negotiate service level expectations and maintain service level agreements with individual vendors;
- Assume loan-level administrative duties for the large numbers of transactions in their pipelines, including (i) performing order entry and assignment, (ii) tracking order status, (iii) updating clients on delays, (iv) performing both pre- and post-delivery quality control, (v) transmitting preliminary and final hard copies of appraisal reports to clients, (vi) handling accounts payable and receivable, (vii) engaging in dispute resolution between lenders and appraisers, (viii) providing and administering warranties and errors and omissions insurance, and (ix) ensuring proper record retention;
- Provide a single point of contact for lenders and uniformity across jurisdictions;
- Offer advanced technology interfacing specializing in the assignment, tracking, and reviewing of appraisal reports and the electronic delivery of reports consistent with the needs of the lender and/or investor; and
- Warrant the quality of the final appraisal product to supplement the errors and omissions insurance carried by appraisers.

The Dodd-Frank Act State Registration and Regulatory Requirements

AMCs are subject to multiple regulatory requirements. First, existing banking regulatory standards are imposed on AMCs as the agents of federally regulated banks and lenders. Second, AMCs are subject to registration requirements and other standards of conduct under state laws. Third, AMCs are the subject of new regulatory requirements, including new minimum standards and a national registry applicable to AMCs under the Dodd-Frank Act. Finally, because mortgage lenders are the AMCs' clients, any appraisal reforms targeted at lenders also have a direct effect on the operations of an AMC.

The Dodd-Frank Act amends the Financial Institutions Reform, Recovery and Enforcement Act of 1989 to require the federal Appraisal Subcommittee to monitor the requirements established by states to register and supervise the activities of AMCs.² The Dodd-Frank Act requires the federal banking agencies to jointly, by rule, establish minimum requirements to be applied by a state in the registration of certain AMCs, including a requirement that AMCs (except a subsidiary which is owned and controlled by a federal financial institution) be registered and regulated by a state appraiser board, a requirement that AMCs verify that only licensed or certified appraisers are used for federally-related transactions, a requirement that AMCs require appraisals to comply with Uniform Standards of Professional Appraisal Practice, and a requirement that AMCs require appraisals to be conducted independently and free from inappropriate influence in accordance with Section 129E of the Truth in Lending Act ("TILA").³

Prior to the passage of the Dodd-Frank Act, several states had begun the process of enacting AMC laws to require the registration of AMCs, to establish appraisal independence standards applicable to AMCs, to set minimum education and licensing requirements for certain employees of AMCs, to provide for the disclosure of appraisal and appraisal management fees within an appraisal report, and to authorize state appraisal boards or other state agencies to enforce the state AMC laws. Many of these states either already encompassed the minimum standards that are in the Dodd-Frank Act or are now in the process of amending their laws to ensure they reflect the minimum standards enumerated in the Dodd-Frank Act. Other states continue to introduce proposed legislation to provide for the registration and supervision of AMCs. Currently, 29 states have enacted such laws and an additional six states have such laws pending.

AMCs have been actively involved with the states from the inception of these registration laws and have long supported transparency and independence in the appraisal process and the registration of bona fide AMCs. AMCs also are working proactively and collaboratively with state regulatory agencies to craft regulations to implement these laws and ensure that the most effective processes are in place to achieve the goals of the registration laws. AMCs provide valuable services in the course of a real estate appraisal, and it is important to us that appraisals are ordered from reputable and sound AMCs that are committed to transparency in the process, full compliance with all registration laws, and delivering the highest-quality appraisal products.

² See the Dodd-Frank Act, Pub. L. No. 111-203, § 1473(f)(1) (2010).

³ See *id.* § 1473(f)(2).

We also believe it is important to work towards consistency and uniformity in state AMC laws and regulations to ensure that AMCs can effectively implement the necessary compliance procedures to operate on a national basis. We will continue to support the states' efforts to implement reasonable and appropriate laws and standards to better the appraisal industry.

The Dodd-Frank Act "Customary and Reasonable" Appraiser Compensation Requirements

As noted above, AMCs provide valuable services to various parties in the appraisal process. AMCs have contractual agreements with lenders and are compensated by the lender for the appraisal and the AMC services. The fees are combined on the HUD-1 appraisal statement as dictated by the Real Estate Settlement Procedures Act, which permits the appraisal fee to include both services. The government-sponsored enterprises (Fannie Mae and Freddie Mac) and the Department of Housing and Urban Development both recognize that AMCs are key factors in the market and have provided guidance to lenders on the use of AMCs (*see* Mortgagee Letter 2009-28).

The Dodd-Frank Act amended TILA by adding Section 129E to require adherence to appraisal independence standards and also to require that lenders and their agents (including AMCs) compensate appraisers at a "customary and reasonable" rate for appraisal services in the market area of the property being appraised. The Dodd-Frank Act also provided that "evidence for such fees *may* be established by objective third-party information, such as government agency fee schedules, academic studies, and independent private sector surveys." (Emphasis added.) Fee studies, however, are required to "exclude assignments ordered by known appraisal management companies."⁴

The Federal Reserve Board ("Board") was charged with promulgating interim final regulations to implement Section 129E. These interim final regulations became effective April 1, 2011. The Board established two alternative presumptions of compliance for lenders and their agents to satisfy this requirement.

REVAA and FAIR believe that the appraiser compensation standards promulgated by the Board are in compliance with the Dodd-Frank Act, and they reflect the variations in actual services and other factors that exist in the marketplace. Appraisal services are not one-size-fits-all, and we believe the Board has created a compliance structure for the payment of "customary and reasonable" appraisal fees that reflects market realities and ensures that prices paid by consumers will remain competitive.

The first presumption permits lenders and their agents to rely upon recent rates actually paid for appraisal services (including rates paid by AMCs) in the relevant geographic market, adjusted as necessary to account for six other factors such as type of property or scope of work. Although the term "customary and reasonable" was undefined in the Dodd-Frank Act, the Board recognized that the Dodd-Frank Act language is identical to HUD's requirement obligating FHA lenders to ensure that appraisers are paid "at a rate that is customary and reasonable for appraisal

⁴ See Section 129E(i)(1) of TILA.

services performed in the market area of the property being appraised.” Consistent with HUD’s approach within Mortgagee Letter 2009-28, the Board concluded that the marketplace should be “the primary determiner of the value of appraisal services, and hence the customary and reasonable rate of compensation for fee appraisers.”

The second presumption permits reliance on objective third-party information, including fee schedules, studies and surveys prepared by independent third parties such as government agencies, and academic institutions and private research firms, provided they are based on recent rates paid to a representative sample of appraisers in the geographic market of the property being appraised (but excluding compensation paid to appraisers for assignments ordered by an AMC).

REVAA and FAIR believe that the Board correctly implemented Congress’ plain language and intent by establishing two presumptions – one that relies on the recent rates actually paid in the marketplace and one that relies on objective third-party fee surveys that exclude fees charged by AMCs. There are currently very few third-party fee surveys in the marketplace, none are comprehensive enough to include all of the differences in geographic areas/markets, and they do not fully encompass all of the appraisal products offered by AMCs.

We understand that the Board does not plan to issue a “final” rule before its rulemaking authority is transferred to the Consumer Financial Protection Bureau (“CFPB”). While the interim final rule remains effective without such “finalization,” AMCs are concerned that some appraisers may seek reconsideration by the CFPB with the intention to mandate a higher level of compensation for appraisers than is supported by current market rates. Under this scenario, consumers would be subjected to higher appraisal fees that would often exceed the market rate and would not be gaining additional services for these higher fees. Furthermore, guaranteeing a higher fee for appraisers would not ensure better performance, as experience has shown that higher appraisal fees do not necessarily correspond to higher quality appraisals. Appraisers are required by the Uniform Standards of Professional Appraisal Practice to ensure that appraisals meet minimum requirements regardless of the fee or the nature of the assignment.

Prior to recent regulatory reforms, higher appraisal fees were the custom for many appraisers who, in partnership with overzealous mortgage brokers and lenders, produced appraisal reports that were impacted by inappropriate influence and coercion. The resulting appraisals often reflected inflated values, which certainly did not constitute “high quality” appraisals. The members of REVAA and FAIR respectfully suggest that the Board, the CFPB, and Congress should resist calls from those appraisers to mandate increased rates for appraisals as opposed to allowing the marketplace to dictate appraisal rates.

In addition to the items discussed previously regarding the potential negative impacts on consumers by mandating a higher level of compensation, it is also important to note that there is no single standard or uniform price for appraisals throughout the country. Instead, appraisal fees are set by the competitive marketplace and reflect variations in the scope of work performed by appraisers, the nuances of individual transactions, such as the type and location of the property, the costs associated with producing appraisals in different markets, how quickly the lender has required the report, and the appraiser’s level of efficiency in performing an assignment.

Indeed, while Section 129E(i) of TILA provides that lenders and their agents may generally rely on fee studies created by objective third parties to form the basis for “customary and reasonable rates,” no reliable and objective fee studies exist across the appraisal spectrum. In fact, two studies that are referenced most actively in the appraisal community to support uniform higher fees demonstrate significant difference between fees within those two surveys for the same areas, do not represent the appraisal industry as a whole, and do not account for the fact that appraisals have multiple uses and multiple markets. Further, we are concerned that undue reliance on fee studies may result in increased collusion among some appraisers to set their fees at artificially high rates, thus influencing fee studies in their area and ensuring that inflated appraisal prices are paid for years to come. In fact, we are already seeing an increasing trend towards price-fixing among appraiser groups in certain states.


The AMC model is a prime example of why a link between higher fees and higher quality appraisals is not a realistic representation of the market. Notably, because of the services and many efficiencies provided by AMCs on behalf of individual appraisers, appraisers are willing to set their appraisal prices at a lower rate for orders accepted from AMCs due to the benefits an appraiser received by working with an AMC. Additionally, AMCs go to great lengths to ensure that only the most qualified and experienced appraisers belong to their networks, with many relationships existing over a 10-15 year period or longer. Appraisers recognize and utilize the extensive quality control processes provided by AMCs to increase the quality of appraisal reports that they produce. Accordingly, while appraisers may set their prices lower when utilizing AMCs, AMCs produce high quality appraisals by ensuring that inappropriate influence does not occur during the appraisal process and by having multiple layers of quality control.

We hope that the CFPB, in issuing final regulations to implement the appraiser compensation standards required by the Dodd-Frank Act, will maintain the compliance structure for the payment of “customary and reasonable” appraisal rates that the Board established.

Conclusion

Thank you for the opportunity to provide testimony and insight in support of the important work of Congress. REVAA and FAIR members play an important role in the housing market, and we hope that you will continue to look to us as a resource going forward.

“TRUTH IN TESTIMONY” DISCLOSURE FORM

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| 1. Name: | 2. Organization or organizations you are representing: |
| Don Kelly | Real Estate Valuation Advocacy Assoc. & Coalition to Facilitate Appraisal Integrity Reform |
| 3. Business Address and telephone number: <div style="background-color: black; height: 80px;"></div> | |
| 4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify? | 5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify? |
| Yes No X | Yes No X |
| 6. If you answered yes to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets. | |
| N/A | |
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Please attach a copy of this form to your written testimony.